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Under the provisions of the Trust, only the City may make contributions to the Trust. No portion of the principal or income of Trust shall be used for or diverted to any

purpose other than the payment of Plan benefits and the reasonable expenses incurred in the supervision and administration of Trust. Private interests will neither participate in nor benefit from the operation of Trust other than as providers of goods or services for reasonable compensation.

The Trust Agreement may be amended at any time by City. Further, Trust is irrevocable unless and until there are no longer any participants eligible for benefits from Trust. Upon termination of Trust and satisfaction of all liabilities of Trust, any remaining assets shall be returned to City or transferred to another entity that meets the requirements of § 115 of the Code. In no event will Trust assets be distributed to an entity that is not a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under § 115 of the Code.

LAW & ANALYSIS

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign to properly conduct. In addition, pursuant to § 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Trust provides health coverage to retired employees of City, a political subdivision of State. Providing health benefits to current and former employees of a

political subdivision constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Trust performs an essential governmental function within the meaning of § 115(1) of the Code.

The income of Trust accrues to City. The benefit to the participating employees is incidental to the public benefit. See Rev. Rul. 90-74.

Based on the information and representations submitted by the City, we hold that the income of Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1). Accordingly, Trust's income is excludable from gross income under § 115(1) of the Code.

No opinion is expressed concerning the federal tax consequences under any provision of the Code other than those specifically cited above. In particular, no representation is made that contributions or premiums paid on behalf of or benefits received by employees, former employees, retirees, spouses, dependents or others will be tax-free. This ruling concerns only the federal tax treatment of Trust's income and may not be cited or relied upon as to any matter relating to the taxation of accident or health contributions or benefits.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Sylvia Hunt
Assistant Chief, Exempt Organizations Branch 2
Division Counsel/Associate Chief Counsel
(Tax Exempt & Government Entities)

Enclosures: Copy of this letter
Copy for § 6110 purposes